Corporate Tax team

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Capital gains tax reforms

The Government will be making controversial changes to CGT in April this year. In an effort to reduce the impact of these reforms, the Chancellor has announced the introduction of a new Entrepreneur's Relief which will apply from 6 April 2008. We review the impact of this new relief, highlighting actions to be taken.

As announced in the Pre-Budget Report last October, there will be major changes to CGT in April this year. For disposals of capital assets on or after 6 April 2008, there will be a single rate of CGT of 18% which will apply to individuals, trustees and personal representatives. The tax-free annual exempt amount (currently £9,200) will remain, but taper relief and indexation allowance will be withdrawn completely.

For some, this will mean a substantial increase in the potential CGT charge on future disposals of shares or assets - under the current regime, business asset taper relief can potentially confer an effective 10% CGT rate if the various requirements for the relief are satisfied. In response to lobbying from business groups, the Government has announced a (very limited) concession in the form of "Entrepreneur's Relief". With effect from 6 April 2008, the first £1 million of gains that qualify for this relief will be charged at an effective 10% rate although gains in excess of this amount will be within the new 18% regime.

This concession has already met with heavy criticism: if entrepreneurs/business owners are considering a sale and expect to realise substantial gains, the concession does not provide much relief from the new 18% rate. These individuals will still need to consider whether they can achieve a sale before 6 April in order to stay within the existing business asset taper relief rules.

Draft legislation on the new relief is not yet available but it appears from the HM Treasury and HMRC press releases that it will only apply:

- to disposals of the whole or part of a trading business (not including a property letting business other than furnished holiday lets), and
- to disposals of shares (and securities including, for example, loan notes) in a trading company ***but only if*** the shareholder making the sale:
    - has been an officer or employee of the company or another company within the same group, and
    - owns at least 5% of the ordinary share capital of the company giving him at least 5% of the voting rights.

Although a little unclear from the press releases, it seems that these conditions need only to be met for one year for the relief to apply.

Based on the information that we have available, points to note are:

- those who are just investors in , and not employees or directors of, a trading company will not benefit (for example, private equity investors who are not directors). The position of, say, the original founders of a business who have subsequently taken a back seat in running the operations seems a little more assured - the seller can be an employee or officer or someone who *has been* an employee or officer

- it is unclear whether those who accept (or who have accepted) loan notes in the purchaser in consideration for their shares will be entitled to the relief when they finally redeem (this may lead to an increase in cash disposals or part cash/part loan note sales)
- it is indicated that the relief will be cumulative over the taxpayer's lifetime up to a total of £1 million of gains. Precisely how carried forward losses will interact with the new relief is unclear
- it is not yet clear whether the new relief will limited to unlisted shares/securities or whether it will apply to fully listed shares/ securities as well
- if the requirements for the relief need only be satisfied for one year, this may benefit some sellers. Maximum business asset taper relief is not currently available unless the business assets have been held for at least two years
- it is unclear how the new relief will interact with the rules for share option schemes - if at all
- those who will currently benefit from frozen indexation allowance (for assets held before 6 April 1998) may still face higher tax costs even with the new relief and
- in his statements to the House, the Chancellor promised to keep the scope of this relief under review. In addition, further anti-avoidance legislation is proposed which will prevent individuals converting income into capital in order to benefit from the lower CGT rates

Action

- Individuals who stand to realise substantially more that £1 million in capital gains and who will benefit from maximum business asset taper relief should still be trying to achieve a cash sale before 6 April 2008. However, timing pressure will be off sellers who are within or close to the £1 million threshold.
- Loan note holders with substantial unrealised gains should be considering whether they can negotiate an early redemption.
- Other tax planning may be possible - although whether this will be appropriate (given the other tax consequences - stamp duty and inheritance tax in particular) will depend on the precise circumstances of each case.
- Once the draft legislation for the new relief is available, we may need to think carefully about structuring post 6 April sales in order to maximise entitlement to the new 10% rate.

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